BANK OF CANADA
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Monetary Policy Report Summary

October 2012

This text is a commentary of the Governing Council of the Bank of Canada. It presents the Bank's outlook based on data received up to 19 October 2012.

The global economy has unfolded broadly as the Bank projected in July. The economic expansion in the United States is progressing at a gradual pace. Europe is in recession and recent indicators point to a continued contraction. In China and other major emerging economies, growth has slowed somewhat more than expected, though there are signs of stabilization around current growth rates. Notwithstanding the slowdown in global economic activity, prices for oil and other commodities produced in Canada have, on average, increased in recent months. Global financial conditions have improved, supported by aggressive policy actions of major central banks, but sentiment remains fragile.

In Canada, while global headwinds continue to restrain economic activity, domestic factors are supporting a moderate expansion. Following the recent period of below-potential growth, the economy is expected to pick up and return to full capacity by the end of 2013. The Bank continues to project that the expansion will be driven mainly by growth in consumption and business investment, reflecting very stimulative domestic financial conditions. Housing activity is expected to decline from historically high levels, while the household debt burden is expected to rise further before stabilizing by the end of the projection horizon. Canadian exports are projected to pick up gradually but remain below their pre-recession peak until the first half of 2014, reflecting weak foreign demand and ongoing competitiveness challenges. These challenges include the persistent strength of the Canadian dollar, which is being influenced by safe-haven flows and spillovers from global monetary policy.

After taking into account revisions to the National Accounts, the Bank projects that the economy will grow by 2.2 per cent in 2012, 2.3 per cent in 2013 and 2.4 per cent in 2014.

Highlights

- Global economic activity has slowed, as expected in July.
- In Canada, following the recent period of below-potential growth, the economy is expected to pick up and return to full capacity by the end of 2013, slightly later than in July.
- The Bank projects that the economy will grow by 2.2 per cent in 2012, 2.3 per cent in 2013 and 2.4 per cent in 2014.
- Core inflation is expected to increase gradually over coming quarters, reaching 2 per cent by the middle of 2013. Total CPI inflation is projected to return to target by the end of 2013, somewhat later than previously anticipated.
- On 5 September and 23 October, the Bank maintained the target for the overnight rate at 1 per cent.

Core inflation has been lower than expected in recent months, reflecting somewhat softer prices across a wide range of goods and services. Core inflation is expected to increase gradually over coming quarters, reaching 2 per cent by the middle of 2013 as the economy gradually absorbs the current small degree of slack, the growth of labour compensation remains moderate and inflation expectations stay well anchored. Total CPI inflation has fallen noticeably below the 2 per cent target, as expected, and is projected to return to target by the end of 2013, somewhat later than previously anticipated.

The inflation outlook in Canada is subject to significant risks. The Bank's projection assumes that authorities in Europe are able to contain the ongoing crisis, and that the U.S. fiscal cliff will be avoided. Imbalances in the Canadian household sector remain the biggest domestic risk. This risk is two-sided.

The three main upside risks to inflation in Canada relate to the possibility of higher global inflationary pressures, stronger Canadian exports and renewed momentum in Canadian residential investment.

The three main downside risks to inflation in Canada relate to the European crisis, weaker demand for Canadian exports and the possibility that growth in Canadian household spending could be weaker.

Projection for global economic growth

	Share of real global GDP[a] (per cent)	Projected growth[b] (per cent)			
		2011	2012	2013	2014
United States	19	1.8 (1.7)	2.1 (1.9)	2.3 (2.1)	3.2 (3.0)
Euro area	14	1.5 (1.5)	-0.5 (-0.6)	0.4 (0.3)	1.0 (1.3)
Japan	6	-0.7 (-0.7)	2.2 (2.5)	1.0 (1.3)	1.1 (0.9)
China	14	9.3 (9.3)	7.6 (7.8)	7.7 (7.8)	7.7 (7.8)
Rest of the world	47	4.3 (4.3)	3.2 (3.2)	3.1 (3.2)	3.3 (3.3)
World	100	3.8 (3.8)	3.0 (3.1)	3.1 (3.1)	3.5 (3.5)

a. GDP shares are based on International Monetary Fund (IMF) estimates of the purchasing-power-parity (PPP) valuation of country GDPs for 2011. Source: IMF, *World Economic Outlook*, October 2012

b. Numbers in parentheses are projections used for the July 2012 *Monetary Policy Report*.

Source: Bank of Canada

Summary of the base-case projection for Canada[a]

	2011	2012				2013				2014			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP (quarter-over-quarter percentage change at annual rates)	2.1 (1.9)	1.8 (1.9)	1.9 (1.8)	1.0 (2.0)	2.5 (2.3)	2.6 (2.3)	2.6 (2.4)	2.6 (2.6)	2.5 (2.7)	2.3 (2.5)	2.2 (2.3)	2.2 (2.2)	2.2 (2.2)
Real GDP (year-over-year percentage change)	2.4 (2.2)	2.2 (1.8)	2.9 (2.5)	1.7 (1.9)	1.8 (2.0)	2.0 (2.1)	2.2 (2.3)	2.5 (2.4)	2.5 (2.5)	2.5 (2.6)	2.4 (2.6)	2.3 (2.4)	2.2 (2.3)
Core inflation (year-over-year percentage change)	2.1 (2.1)	2.1 (2.1)	2.0 (2.0)	1.5 (1.9)	1.6 (1.9)	1.7 (1.9)	1.8 (2.0)	2.1 (2.0)	2.1 (2.1)	2.1 (2.1)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)
Total CPI (year-over-year percentage change)	2.6 (2.6)	2.4 (2.4)	1.6 (1.7)	1.2 (1.2)	1.5 (1.6)	1.4 (1.5)	1.4 (1.5)	1.7 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)
Total CPI excluding the effect of the HST and changes in other indirect taxes (year-over-year percentage change)	2.5 (2.5)	2.2 (2.2)	1.4 (1.6)	1.1 (1.1)	1.4 (1.5)	1.4 (1.5)	1.5 (1.6)	1.8 (2.1)	2.1 (2.1)	2.1 (2.1)	2.0 (2.0)	2.0 (2.0)	2.0 (2.0)
WTI[b] (level)	94 (94)	103 (103)	93 (93)	92 (86)	92 (87)	93 (88)	94 (89)	94 (89)	94 (89)	93 (88)	92 (88)	92 (87)	91 (87)
Brent[b] (level)	109 (109)	118 (118)	109 (109)	109 (100)	113 (99)	112 (98)	110 (98)	108 (98)	107 (97)	105 (96)	104 (96)	102 (95)	101 (94)

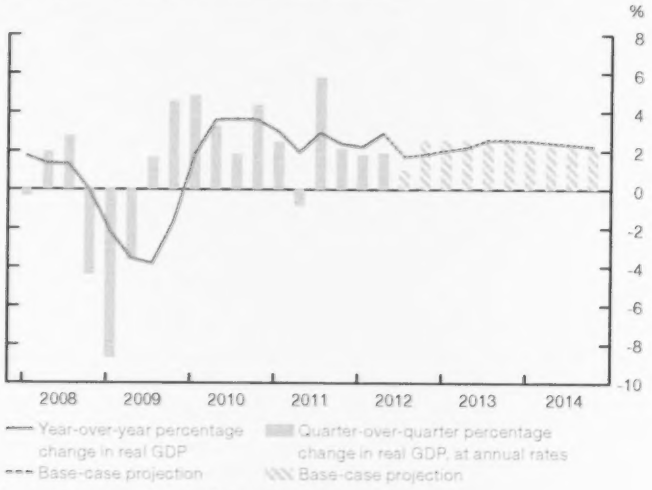
a. Figures in parentheses are from the base-case projection in the July 2012 *Monetary Policy Report*.

b. Assumptions for the prices of West Texas Intermediate and Brent crude oil (US$ per barrel), based on an average of futures contracts over the two weeks ending 19 October 2012

Overall, the Bank judges that the risks to the inflation outlook in Canada are roughly balanced over the projection period.

Reflecting all of these factors, on 23 October, the Bank decided to maintain the target for the overnight rate at 1 per cent. Over time, some modest withdrawal of monetary policy stimulus will likely be required, consistent with achieving the 2 per cent inflation target. The timing and degree of any such withdrawal will be weighed carefully against global and domestic developments, including the evolution of imbalances in the household sector.

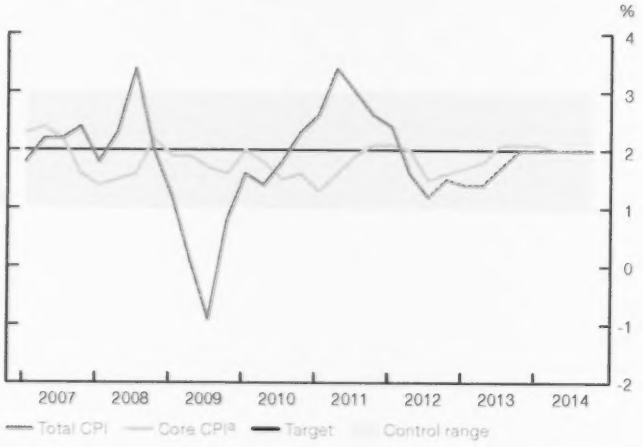
Real GDP is expected to grow at a moderate pace



Sources: Statistics Canada and Bank of Canada calculations and projections

Total CPI inflation in Canada is projected to remain below 2 per cent until the end of 2013

Year-over-year percentage change, quarterly data



a. CPI excluding eight of the most volatile components and the effect of changes in indirect taxes on the remaining components

Sources: Statistics Canada and Bank of Canada calculations and projections

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